TABLE OF AUTHORITIES

CASES

STATUTES AND CONSTITUTIONS

OTHER AUTHORITIES

I. THE NATURE OF THE CASE

This case challenges the constitutionality of a number of provisions of 1999 AB 495 (1999 Wis. Act 11, hereinafter, "Act 11") which makes significant changes to the Wisconsin Retirement System (the "WRS"). This challenge implicates the most fundamental of trust principles, the requirement that trust funds be used only in accordance with the terms of the trust.

The assets held in trust in the WRS may only be used to satisfy benefit commitments to WRS participants. Act 11, however, directs the use of Trust Fund assets to relieve participating employers from their statutory contribution requirements to the WRS. In addition, Act 11 makes a number of changes to the actuarial assumptions used in establishing WRS contribution rates (all in a manner that benefits participating employers), and implements increases in benefits without allocating sufficient state funds to finance such increased benefits.

The changes to the WRS made by Act 11 are the latest legislative attempts to tap into the substantial resources of the WRS in a manner that provides a direct fiscal benefit to the State of Wisconsin and other participating employers who have no beneficial interest in the assets or earnings of the WRS. If the legislature is free to utilize WRS assets as a ready source of cash to meet the State's budgetary cash flow needs or as a fund from which employers are free to drain

existing cash reserves, then the substantial assets of the WRS are at risk for future legislative conversions that could threaten the solvency and actuarial soundness of the WRS. The very ability to remove dollars from the WRS either directly or indirectly, for purposes other than paying benefit commitments associated with those funds, poses a significant danger to the future and security of the WRS.

II. THE WISCONSIN RETIREMENT SYSTEM

A. Establishment and Purpose of the Wisconsin Retirement System.

The Wisconsin Retirement System was established pursuant to Chapter 40, Stats., for the sole purpose of providing retirement and related benefits to public employees. The WRS is funded through the public employe trust fund (hereinafter, "Trust Fund") created by § 40.01, Stats.[1] The sole purpose of the Trust Fund is to aid public employees in protecting themselves and their beneficiaries against the financial hardships of old age, disability, death, illness and accident. Stip. ¶ 3, P. App. 2-3[2], § 40.01(1), Stats.[3] The WRS is administered by the Department of Employe Trust Funds (hereinafter "DETF") and its appointed secretary. Stip. ¶¶ 4 and 5, P. App. 3. The DETF is a Wisconsin state agency

[1]Unless otherwise noted, all statutory references are to the Wisconsin Statutes.

[2]"P. App." refers to the SEA Petitioners' Appendix.

[3]"Stip" refers to the stipulation entered into by the parties herein.

created under the direction and supervision of the Employe Trust Funds Board (the "ETF Board"); each member of the ETF Board is a trustee of the Trust Fund. Stip. ¶ 4, P. App. 3, § 40.01(2), Stats.

The purpose of the Trust Fund is contained in § 40.01(2), Stats., which provides in relevant part as follows:

> The public employe trust fund is a public trust and shall be managed, administered, invested, and otherwise dealt with **solely** for the purpose of ensuring the fulfillment at the lowest possible cost of the **benefit commitments to participants, as set forth in this chapter, and shall not be used for any other purpose**.

Stip. ¶ 3, P. App. 2-3, § 40.01(2), Stats. (emphasis added).

B. The Fixed Retirement Investment Trust and Its Reserves and Accounts

Within the Trust Fund there is a fixed retirement investment trust into which funds contributed by and on behalf of participants[4] are deposited. § 40.04(3), Stats. The fixed retirement investment trust is comprised of 12 accounts and reserves, all of which are affected by Act 11 except the Milwaukee Retirement Systems Account and the undistributed earnings account, neither of which is credited with annual effective rate interest. Stip. ¶ 13, P. App. 5. Three of the reserves and one account are of principal concern to the understanding of the effects and intent of Act 11: (1)the employee accumulation reserve account; (2)the employer

[4]A "participant" means any person included within the WRS by virtue of being or having been a participating employe whose account has not been closed under § 40.25(1), (2) or (2m). § 40.02(45), Stats.

accumulation reserve account; (3) the annuity reserve account; and (4)the transaction amortization account. For purposes of this case, these four reserves and accounts may be collectively referred to as the "FRIT." Stip. ¶ 14, P. App. 6.

1. The Employee Accumulation Reserve

The employee accumulation reserve is the account to which employee required contributions are credited. § 40.04(4), Stats. Within the employee reserve, a separate account is maintained for each participant. Stip. ¶ 66, P. App. 24, § 40.04(4), Stats. In many cases, employers have agreed to "pick up" employee required contributions, and pay them on behalf of participating employees as part of their compensation package.[5] All regular employee required contributions whether paid by the participating employee, or by the employer on behalf of a participating employee, are credited to the participating employee's individual account in the employee accumulation reserve. Stip. ¶ 14, P. App. 6, *See, also,* R. 2 at 23, P. App. 30.[6] Investment earnings on the employe accumulation reserve account balances are credited to each participant's individual account.

---

[5]A "participating employe" is an employe who is currently in the service of, or an employe who is on a leave of absence from, a participating employer under the WRS and who has met the requirements for inclusion within the provisions of the WRS under § 40.22. § 40.02(46).

[6]"R." refers to documents contained in the stipulated exhibits herein.

2. The Employer Accumulation Reserve

The employer accumulation reserve is a single merged account to which employer required contributions are credited. Unlike the employee accumulation reserve account, employer contributions are not separately maintained in individual employer accounts, but rather, are pooled. Stip. ¶ 17, P. App. 7, § 40.04(5), Stats. In addition, all benefit adjustment contributions[7], whether paid by employees or employers, and such other amounts as provided in § 40.04(5) are credited to the employer accumulation reserve. Stip. ¶ 14, P. App. 6, § 40.04(5), Stats. Investment earnings on the pooled employer accumulation reserve account balance are credited to the employer accumulation reserve.

3. The Annuity Reserve

The annuity reserve is the account into which funds are transferred from the employer and employee accumulation reserves for the purpose of paying WRS annuities. When an eligible participant elects to take an annuity, the balance of the participant's account in the employe accumulation reserve is transferred into the annuity reserve and held there to fund the annuity benefit. Any additional amount necessary to equal the present value of the annuity is transferred from the

[7]Benefit adjustment contributions are discussed in greater detail, *infra.*

employer accumulation reserve to the annuity reserve account. Stip. ¶ 14, P. App. 6, § 40.04(6), Stats.

4. The Transaction Amortization Account

The transaction amortization account, created by § 40.04(3), Stats. (hereafter referred to as the "TAA"), accounts for realized and unrealized gains and losses from the Fixed Retirement Investment Trust's investments. Stip. ¶ 14, P. App. 6, § 40.04(3). Prior to 1973 Act 137, all gains and losses of the Fixed Retirement Investment Trust were fully distributed in the year the gain or loss was realized. In other words, prior to the TAA, gains and losses were fully distributed in the year that investments were sold and a gain or loss was actually realized. This led to contribution and benefit rates that fluctuated significantly or had the potential for volatile fluctuations annually.

In 1975, per Chapter 137, Laws of 1973, the TAA was first implemented. Since implementation of the TAA, realized and unrealized gains and losses in market value of the invested assets of the Fixed Retirement Investment Trust are credited to the TAA as they are incurred. In other words, unrealized gains and losses (along with those that have been realized), or paper gains and losses, are credited to the TAA even though the investment has not been sold. Realized and unrealized gains and losses are recognized and distributed to the accounts and reserves in the Fixed Retirement Investment Trust over a period of years. Each recognition from the TAA is

distributed to the other reserves and accounts of the Fixed Retirement Investment Trust (except the Milwaukee Retirement Systems account and the undistributed earnings account) in the same ratio as each account's average daily balance within the Fixed Retirement Investment Trust bears to the total average daily balance of all participating accounts in the Fixed Retirement Investment Trust. § 40.04(3)(a), Stats. This is done by crediting interest to the reserves and accounts at the "effective rate" defined in § 40.02(23)(a). Stip. ¶¶ 19-20, 23, P. App. 8,9.

The purpose of the TAA is to smooth the impact of investment gains and losses on the Fixed Retirement Investment Trust. By extending the time period over which investment gains and losses are recognized, the TAA tends to stabilize contribution rates. R. 2 at 28, P. App. 35. Since 1975, a percentage of the balance of the TAA has been periodically recognized and credited as current income to the Fixed Retirement Investment Trust. § 40.04(3)(a) and previously § 40.06(3)(a), 1975-1979. From 1975 to 1988, 7% of the TAA balance was credited annually. Starting in 1989, 20% of the TAA balance has been credited annually. 1989 Wis. Act 13; § 40.04(3)(a). *See,* Stip. ¶ 21, P. App. 8.

C. Employer and Employee Contributions and Unfunded Prior Service Liability

The FRIT receives funds from three sources: (1) contributions from or on behalf of participating employees; (2) contributions from participating employers; and (3) investment earnings on the employee and employer contributions. Stip. ¶ 15, P. App. 6.

1. Employee Required Contributions

Employe required contributions to the Trust Fund are comprised of essentially two components. The first component is the basic required contributions set by statute as a percentage of a participating employee's earnings. The applicable contribution percentage varies among participating employees based upon their employment category, with separate percentages applicable to the following categories of employees: (1) general employees; (2) elected and state executives; (3) protective[8] employees under social security; and (4) protective employees not under social security. Stip. ¶ 26, P. App. 11, § 40.05(1), Stats.

[8]A "protective occupation participant" includes those participants described in § 40.02(48), Stats. and includes those engaged in active law enforcement or fire suppression or prevention, provided the duties require frequent exposure to a high degree of danger or peril and also require a high degree of physical conditioning.

A second component of employee required contributions are benefit adjustment contributions pursuant to § 40.05 (2m), Stats. These contributions were initially set at 1% of earnings, and were only required to be paid by general employees and protective occupation employees receiving social security.[9] For accounting purposes, the statute provides that all benefit adjustment contributions are to be treated as if they are employer contributions, and thus, are credited to the employer accumulation reserve, not the individual accounts in the employee accumulation reserve. R. 2 at 36, 37, P. App. 43, 44, § 40.05(2m), Stats.

Benefit adjustment contributions were initially created to help fund the increases in retirement benefits created by 1983 Wisconsin Act 141. Since 1989, § 40.05(2n), Stats. has provided that when the ETF Board, upon advice of the actuary, determines that an increase or decrease in contribution rates is necessary to maintain the financial balance of the WRS, any such change is to be apportioned equally between the employer-required contribution rate and the benefit adjustment contribution rate. In the event that a decrease would reduce

[9]This constitutes the vast majority of employees, and the only employees that were not initially required to pay benefit adjustment contributions were Elected Officials, State Executives, and Protective Occupation Employees who are not under social security (firefighters).

the benefit adjustment contribution rate below zero, the statutory employe contribution rate itself must be decreased. R. 2 at 34, 36, P. App. 41, 43, § 40.05(2n)(b). Thus, subsequent changes to contribution rates are split evenly between employers and employees. Stip. ¶ 26, P. App. 11. These increases and decreases have been applied to all categories of employees, and there have been time periods during which the categories of employees originally excluded from paying benefit adjustment contributions have paid such contributions due to an increase in contribution rates. R. 2 at 37, P. App. 44.

Like other employee required contributions, benefit adjustment contributions may be "picked up" by employers and paid on behalf of participating employees as part of their compensation package.

2. Employer Required Contributions

Employer required contributions consist of essentially two components, current service contributions and contributions for unfunded prior service liabilities. Current service contribution rates are assessed against all participating employers. These contributions are not set in the statutes but are, instead, determined as part of each annual actuarial evaluation of the WRS conducted by the WRS consulting actuary. Each year, the WRS consulting actuary evaluates the funding requirements for the WRS in order to meet the costs of estimated future retirement benefits for

participants. The annual contribution rate developed for employers is the amount sufficient to fund such costs (called "normal costs") net of all revenues received from the statutory employee-required contributions, the benefit adjustment contributions, and those investment earnings credited as current income. Stip. ¶ 28, P. App. 12.

The annual review is conducted utilizing actuarial assumptions determined during the WRS consulting actuary's tri-annual review. The tri-annual review is a general investigation of the WRS, conducted every three years, relating to mortality, disability, retirement, separation, interest, employee earnings rates and any other factors deemed pertinent in determining contribution rates. Stip. ¶ 27, P. App. 11. Among the actuarial assumptions determined during this tri-annual review is the "assumed rate" as defined in § 40.02(7), Stats. as "the probable average effective rate expected to be earned for the fixed annuity division on a long term basis" and an assumption for across the board salary increases. Each of these assumptions was statutorily changed by the provisions of Act 11.

The second component of employee required contributions, are employer obligations for unfunded prior service liabilities owed to the WRS (hereafter referred to as "unfunded liability"). § 40.05(2)(b), Stats., Stip. ¶ 31, P. App. 13. An employer's unfunded liability is the result of an employer granting service credit under the WRS to an employee

for services rendered by the employee before the employer joined the WRS, and the increase in those liabilities resulting from subsequent benefit improvements. When an employer first elects to join the WRS, the statutes authorize the employer to recognize for retirement crediting purposes either 100%, 75%, 50%, 25% or 0% of the prior service of its employees for the period prior to the employer's participation in the WRS. Where the employer chooses to recognize some or all of these prior service credits, the credits become an unfunded liability owed by that employer to the WRS. These unfunded liabilities increase when improvements in WRS retirement benefits are authorized by the legislature, and eligibility for these benefit improvements is granted retroactively to WRS participating employees. R. 2 at 39, P. App. 46, Stip. ¶ 31, P. App 13.[10]

[10]"To date, the Legislature has always provided that major benefit improvements be applied both prospectively and retroactively." R. 2 at 39.

Employer contribution rates for the payment of unfunded liability are amortized over 40 years. § 40.05(2)(b), Stats. An employer must continue to make contributions toward its unfunded liability, plus interest at the assumed rate (§ 40.05(2)(b), Stats.), until the entire debt has been paid to the WRS. Stip. ¶ 32, P. App. 13-14, § 40.05(2)(bm) .[11] The Attorney General has concluded that there is no statutory authority for the ETF Board to adjust employer unfunded liability balances based on subsequent changes in the actuarial assumptions used to calculate employer contribution rates -- unfunded liabilities are a fixed employer obligation "determined as of the effective date of the employer's WRS participation". R. 10 at 9, P. App. 72. Wisconsin Statutes specifically authorize employers to pay-off their unfunded liability in advance. Stip. ¶ 32, P. App. 13-14, §§ 40.05(2)(b), (bg), (bm), Stats.

D. WRS Retirement Benefits

For persons who maintain covered employment under the WRS or who leave covered employment but do not take a separation benefit prior to reaching normal retirement age[12], the WRS

[11] Because the unfunded liability contribution is a percentage of the employer's WRS-covered payroll, changes in the covered payroll mean the employer may be making actual payments that are greater, or less, than the annual amount necessary to actually pay the employer's unfunded liability in exactly 40 years. Stip. ¶ 32.

[12] "Normal retirement age" is the age set by statute at which a participant may begin to receive an unrestricted regular retirement annuity. This age varies depending on the participant's employment classification. *See,* R. 2 at

offers two retirement plans: the formula benefit retirement plan, which is a defined benefit plan, and the money purchase retirement plan, which is a defined contribution plan. In general, the formula benefit will result in a higher annuity payment for employees who remain in WRS-covered employment until retirement, while the money purchase benefit will result in a higher annuity for person who ended WRS covered employment many years before applying for a retirement benefit. R. 2 at 48, P. App. 55. The greater of the formula benefit annuity or the money purchase annuity will always be paid to the retiring participant. R. 2 at 49, 53-54, P. App. 56, 60-61, § 40.23(2m)(b), Stats.

51.

The formula benefit for persons achieving normal retirement age is equal to the product of the participant's number of years of creditable service[13] times the monthly final average earning figure[14] times the appropriate formula multiplier for the participant's employment classification. The formula multiplier is a percentage figure set by statute based on employment classification. § 40.23(2m)(e). The calculated annuity amount may be reduced if the participant elects to retire before reaching normal retirement age. Under current law, the formula benefit annuity can not exceed 65% (85% for protective employes not covered by Social Security) of the participant's final average earnings figure. R. 2 at 49-50. The 65% cap was raised to 70% by the provisions of Act 11.

The money purchase benefit is the annuity that can be purchased, based on standard annuity tables, with a retiring participant's total account balance in the employee accumulation reserve, plus an equal amount from the employer accumulation reserve. This is the minimum retirement benefit that a participant of normal retirement age will receive at retirement. There is no percentage cap on this annuity.

---

[13] "Creditable service" means the number of years a participant was employed by one or more WRS participating employers in a capacity that entitled the employe to accrual of retirement benefits. R. 2 at 48, P. App. 55, § 40.02(17), Stats.

[14] "Final average earnings" are the average of the three years of highest earnings by the participant in covered employment. The three years need not be consecutive.

III. THE CHANGES IMPOSED ON THE WRS BY ACT 11

AB 495, which became 1999 Wis. Act 11, was introduced on October 1, 1999, and was passed in both the Assembly and the Senate on October 6, 1999. The Governor signed Act 11 on December 16, 1999. Stip. ¶¶ 50-53, P. App. 18-19.

A. Recognition of $4 Billion from the TAA

Act 11 provides that, on December 31, 1999, $4 billion from the TAA is to be recognized and distributed to the other reserves and accounts of the fixed retirement investment trust in an amount equal to a percentage of the total distribution determined by dividing each reserve's and account's balance on January 1, 1999 by the total balance of the fixed retirement investment trust on January 1, 1999 (i.e., each account gets a pro-rata share of the distribution). Act 11, § 27(1)(a), P. App. 77. Accordingly, most of the $4 billion distribution is to be recognized into the employer, employe and annuity reserves. Stip. ¶ 55, P. App. 19.

B. Creation of a $200 Million Credit Account for Employers to Be Applied Toward Unfunded Liabilities and Current Service Contributions

Act 11 provides that $200 million of the employer reserve that results from the distribution of $4 billion from the TAA shall be used to establish contribution credits for satisfaction of required payments that individual employers have for unfunded liability. Any credits in excess of an employer's unfunded liability will be used to make payments for their required annual employer contributions (current

service contributions) under the WRS. During the period in which the credits are used, the employers that have unfunded liability will not be required to make payments for unfunded liability, and those employers that do not have unfunded liability (or have credits in excess of such unfunded liability) will not be required to make annual employer-required contributions until their respective credits are exhausted. After an employer's credit is consumed, the employer is required to resume making unfunded liability payments (if a balance remains) and to resume required employer contributions. Stip. ¶ 57, P. App. 20, Act 11, §§ 27(1)(a) and (b)1, P. App. 77.

C. Increased Formula Multiplier Used to Calculate a Participant's Annuity for Creditable Service Performed Before January 1, 2000

Act 11 increases the percentage multipliers used in calculating a participant's formula benefit annuity for creditable service that is performed before January 1, 2000. For a protective occupation participant who is covered by Social Security, an elected official and an executive participating employee, the percentage multiplier is increased from 2% to 2.165%. For a protective occupation participant who is not covered by Social Security, the percentage multiplier is increased from 2.5% to 2.665%. For all other participants in the WRS, the percentage multiplier is increased from 1.6% to 1.765%. The increase in the percentage multiplier applies to the calculation of retirement benefits

for individuals who are participating employees in the WRS on January 1, 2000. For all creditable service performed on or after January 1, 2000, Act 11 provides that the percentage multipliers in effect prior to Act 11 will apply. Stip. ¶ 61, P. App. 22-23, Act 11, §§ 17-20, P. App. 76. Other than the recognition of $4 Billion from the TAA, and the changes in actuarial assumptions unlawfully imposed by the legislature under Act 11, Act 11 does not provide any source for funding this increase in retirement benefits. R. 13 at 5, P. App. 84A.

D. Increased Maximum Amount of Initial Annuity

Under pre-Act 11 law, the maximum amount of an initial annuity for a participant in the WRS (including a protective occupation participant with social security) who receives an annuity based upon a formula benefit, is an amount equal to 65% of the participant's final average earnings ("FAE"), except for a protective occupation participant who is not covered by social security, who is capped at 85% of FAE. Stip. ¶ 62, P. App. 23, § 402.23(2m)(b). For all WRS participants with a 65% cap, Act 11 increases the cap on the initial formula-based annuity from 65% to 70% of FAE. Act 11 makes no change to the 85% FAE cap on the initial formula-based annuity for protective occupation participants without social security. Stip. ¶ 63, P. App. 23.

E. Changes in Actuarial Assumptions

The Board is required to select and retain an actuary or actuarial firm which shall perform all actuarial services necessary for the operation and control of the Trust Fund. § 40.03(1)(d), Stats. Contribution rates and actuarial assumptions determined by the actuary, including the assumed interest rate ("assumed rate") and the assumptions for future changes in employee salary rates, are subject to approval of the Board. § 40.03(1)(e), Stats. These actuarial assumptions determine employee and employer contributions to the Trust Fund and are to be based on the actual experience of the WRS, unless lack of adequate information or unusual circumstances are specifically identified and fully described which require use of other groups' experience and such other experience is not inconsistent with the WRS's own experience. §40.03(5)(b), Stats.

One of the actuarial assumptions used to determine employer contributions is the "assumed rate," defined in § 40.02(7), Stats. as "the probable average effective rate expected to be earned for the fixed annuity division on a long-term basis." Prior to Act 11, § 40.02(7), Stats. set the "assumed rate" at 7.5% (subject to modification by the ETF Board as provided in that statute). Act 11 amends § 40.02(7) to set the assumed rate at 8%. Stip. ¶ 29, P. App. 12, Act 11, § 5, P. App. 73-74. Increases in the assumed rate have the effect of reducing employer and employee required contributions to the Trust Fund.

Another of the actuarial assumptions used to value the liabilities of the WRS is an assumption for across-the-board salary increases. This factor is used to project earnings for each participant between the valuation date and the participant's retirement age so that employee earnings upon which benefits will ultimately be based can be predicted and used in determining contribution rates. R. 4 at II-3, P. App. 80. Prior to Act 11, § 40.02(7) set the actuarial assumption for across-the-board salary increases at 1.9% less than the assumed rate (subject to modification by the ETF Board as provided in that statute). The assumption for across-the-board salary increases has been changed by the ETF Board, upon the recommendation of the actuary, at various times. The current salary assumption was set by the actuary in 1997 and is applicable through the year 2000, and stands at 4.8%. Stip. ¶ 30, P. App. 12-13. Act 11 provides that the actuarial assumption for across the board salary increases shall be set at 3.4% less than the assumed rate (subject to modification by the ETF Board as provided in that statute). This translates to salary increases projected at 4.6%. Act 11, § 5, P. App. 73-74. This is .2% less than that most recently recommended by the WRS actuary and approved by the ETF Board for the 2000 calendar year. This amount was set by the legislature, and was not recommended by the WRS actuary or approved by the ETF Board as provided by statute. The effect of having a lower assumption for across the board salary increases is to reduce

employer and employee required contributions to the Trust Fund.

IV. PRINCIPLES PROTECTING THE WRS

Under the WRS, rights exercised and benefits accrued to an employee for service rendered are due as a contractual right and may not be abrogated by any subsequent legislative act. § 40.19(1), Stats. The monies held in the Fund are not state funds. Opinion of Wis. Att'y Gen. To Michael G. Ellis, Chairperson, Senate Organization Committee, OAG 1-95, 1995 WL 64369 (Feb. 14, 1995). State Engineering Association v. Employe Trust Funds Board, Dane County Case Nos. 88-CV-1070 and 88-CV-4062, *affirmed in part and reversed in part*, 537 N.W.2d 400 (Ct. App. 1995), *affirmed as modified*, 207 Wis.2d 1, 558 N.W.2d 83 (1997), P. App. 103. The monies in the Fund have been irrevocably placed in trust for the benefit of WRS participants and the State cannot direct the use of such money for non-Trust purposes. § 40.01(2), Stats.

WRS participants have a property interest and contractual right in the proper use of the assets and earnings of the Trust Fund. The legislature is not free to spend or appropriate the assets or earnings of the Trust Fund except in a manner and for the purposes specifically authorized by the contractual terms reflected in the statutes relating to the WRS. Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 558-59, 544 N.W.2d 888, 892 (1996). When an

exclusive grant of discretionary authority has been given statutorily to the ETF Board, the WRS participants have a property interest in the preservation of the ETF Board's authority. Retired Teachers Ass'n v. The Employe Trust Funds Bd., 207 Wis. 2d 1, 20, 558 N.W.2d 83, 91 (1997). WRS participants have a contractual relationship with the state and a vested right in the WRS. The WRS participants' property right extends to the WRS as a whole. *Id.* at 19, Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 558, 544 N.W.2d 888, 892 (1996).

"Governmental takings do not become exempt from due process requirements simply because they may be actuarially insignificant. ... The gravity of a property deprivation is irrelevant to the question of whether such rights are violated without due process. *Id.* at 560. Any pension plan's ability to meet its obligations can be jeopardized when funds are taken from it, since every dime is arguably part of a management strategy dependent upon spreading the fund's monies as broadly as possible." *Id.* "While the specific transfer of trust funds ... may not immediately threaten the benefits of vested ... beneficiaries, the precedent set by such a transfer certainly could." *Id.* at 562. It is thus recognized that the mere ability to take or divert trust funds creates a systemic threat to the Trust Fund itself.

Legislative intervention into the Trust Fund that is not authorized by chapter 40 is only constitutional in limited

circumstances such as "when it is necessary to preserve the actuarial soundness of a plan or to salvage financially troubled funds." To be constitutional, legislative intervention must be reasonable, "needed" and "necessary to protect actuarial soundness." *Id.* at 563-64.

V. ACT 11 VIOLATES THE CONTRACTUAL AND PROPERTY RIGHTS OF THE SEA PETITIONERS.

The Trust Fund is not financially troubled, and the provisions of Act 11 were neither needed nor necessary to protect the actuarial soundness of the Trust Fund nor to salvage the Trust Fund. Stip. ¶ 54, P. App. 19. The considerable investment success of the Trust Fund has caused its accounts and reserves to grow to record levels, but just as the balance in the TAA is higher than it has ever been, so too are the assets and liabilities of the WRS. R. 13 at 7, P. App. 85. The relative success of the Trust Fund and the ability of the legislature to remove, or redirect the use of, significant Trust Fund assets without upsetting the actuarial balance of the WRS, does not justify the use of WRS assets for non-Trust Fund purposes. This Court has specifically recognized that the use of WRS assets for non-Trust Fund purposes may not pose an immediate threat to the security of the Trust Fund, but that the security of the Trust Fund is nonetheless institutionally threatened by virtue of the precedent set by such a transfer. Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 558, 544 N.W.2d 888, 892 (1996).

A. The 200 Million Dollar Credit Account Is an Unlawful Use of the Assets of the WRS, Violates the WRS Contract, and Constitutes a Taking of Participants' Property Rights Without Just Compensation and Without Due Process in Violation of Article I, Section 13 of the Wisconsin Constitution and Amendments 5 and 14 of the U.S. Constitution

Article I. § 13 of the Wisconsin Constitution provides as follows:

> The property of no person shall be taken for public use without just compensation therefore.

This proscription is echoed by the Fifth and Fourteenth Amendments to the United States Constitution, which provide as follows:

> ...nor shall private property be taken for public use, without just compensation.
>
> ***
>
> ...nor shall any State deprive any person of ... property, without due process of law

The employer credit account provisions of Act 11 takes WRS participants' private property interest in the earnings of the Trust Fund and uses those earnings for a purpose not authorized by the trust--to pay for unfunded prior service liabilities and current service contribution requirements on behalf of participating employers who have no interest in the assets or earnings of the WRS. The Funds taken are used for a "public purpose" because the reduction in Employer obligations to the Trust Fund inures to the benefit of the public; either through lower taxes, or the availability of additional funds for other public purposes.[15] Required

[15]Each of the provisions of Act 11 challenged herein violate the WRS Contract, as contained in chapter 40. Therefore, each of the challenged portions of Act 11 would also constitute an impairment of contract in violation of Article I, section 2 of the Wisconsin Constitution and Article I, section 10, clause 1 of the U.S. Constitution. This Court has held that participants' contract rights in the WRS constitute a vested property right, and has consistently analyzed violations of the WRS contract under the "takings" provisions of the Wisconsin and U.S. Constitutions -- essentially treating the "impairment" and "takings" causes of action as merged for purposes of analyzing violations of the WRS contract. Therefore, this brief will focus on the "takings" analysis that has been used by this Court in analyzing past violations of the WRS contract. It should be noted, however, that the same

payments that are suspended on the basis of "credit" dollars being available result in a direct and immediate reduction in budget requirements for participating employers with a direct diminution of Trust Fund assets.

1. WRS Participants Have a Constitutionally Protected Property Interest in the Assets and Earnings of the WRS.

In a takings analysis, the first question is whether a property interest exists. Retired Teachers Ass'n v. The Employe Trust Funds Bd., 207 Wis.2d 1, 18, 558 N.W.2d 83, 90 (1997). The Wisconsin Supreme Court has held that WRS participants have a vested property interest in all the assets and earnings of the WRS. Participants have "a property interest in [their] retirement system as a whole." *Id.* at 19., Association of State Prosecutors v. Milwaukee County, 199 Wis.2d 549, 558, 544 N.W.2d 888, 892 (1996). "The earnings on investments ... constitute assets of the [retirement] system.... The right [in the retirement system] includes the proper use of the earnings.... [T]he legislature ... [is] not free to spend or appropriate the earnings of the fund except in a manner authorized by statute relating to the ... retirement system." State Teachers' Retirement Board v.

---

analysis would lead to the conclusion that the provisions of Act 11 challenged herein also violate the state and federal constitutional prohibitions against the impairment of contracts.

Giessel, 12 Wis.2d 5, 10, 106 N.W.2d 301 (1960), *quoted with approval in* Retired Teachers Ass'n v. The Employe Trust Funds Bd., 207 Wis.2d at 19, and Ass'n of State Prosecutors, 199 Wis.2d at 559.

2. The Employer Credit Account Provisions of Act 11 Takes the Property Rights of WRS Participants

When a property interest exists, the next question in the takings analysis is whether the property right has been taken. Retired Teachers Ass'n v. The Employe Trust Funds Bd., 207 Wis.2d 1, 20, 558 N.W.2d 83, 91 (1997). The employer credit account provision of Act 11 "takes" participants' property interest in having the assets and earnings of the Trust Fund used solely for purposes of satisfying benefit commitments to WRS participants, and having investment gains distributed in the manner prescribed by chapter 40. Absent the provisions of Act 11, § 27(1)(a) and (b)1, the current recognition of $4 billion from the TAA would not result in $200 million being applied as a "credit" toward required payments due from participating employers for unfunded liability or current contributions. Instead, the $200 million would be part of the total balance of the employer reserve considered by the actuary as one of several factors to determine contribution rates, and would be used to purchase annuities for WRS annuitants. Stip. ¶ 59, P. App. 21.

Actuary Brian Murphy, of the firm, Gabriel, Roeder and

Smith, the WRS actuary, estimates (based upon the same data and assumptions used to prepare the actuary's November, 1999 report included in the record as Exhibit 13) that if the $200 million transferred into the employer accumulation reserve and earmarked for the exclusive purpose of an employer credit account by Act 11 were not so reserved, these funds would reduce the required contribution percentage rates which would be effective as of January 1, 2001 for each category of WRS employe by the following:

General category employes	0.02%
Elected officials and executives	0.03%
Protectives with Social Security	0.03%
Protectives without Social Security	0.04%

Since no change in contribution rates will actually occur unless the change is at least 0.2%, the $200 Million, if left in the employer reserve, would have had no impact on current employer contribution rates.[16] Stip. ¶ 60, P. App. 21-22. The credit account, however, clearly reduces Trust Fund assets, and will have a very substantial and immediate benefit for participating employers. According to the DETF's preliminary calculations, the $200 million credit will have

[16]Changes too small to be implemented are deferred and affect the next evaluation of contribution rates.

the following effect on each category of participating employer:

Estimated Required Payments and Credits for Unfunded Liabilities
(based on 12/31/1998)

	A	B	C	D	E	F	G
Employer Unit	Number of Units	Covered Payroll (in millions)	Unfunded Liabilities Req'd Contributions per year (in millions)	Share of $200 million Credit (in millions)	%Share of $200 million Credit	Total Unfunded Liabilities (in millions)	Paydown of Credit (in Months)
State	59	2,386.0	30.6	56.3	28.1%	661.5	22.1
Cities	187	843.3	10.1	20.2	10.1%	244.4	24.0
Villages	185	109.1	1.1	2.6	1.3%	23.1	28.1
Special Districts	152	82.2	0.4	1.9	1.0%	7.4	58.2
Towns	144	34.2	0.3	0.8	0.4%	4.9	32.8
Counties	71	1,048.6	13.0	24.7	12.4%	259.5	22.8
School Districts	426	3,560.9	51.4	84.0	41.9%	905.1	19.6
Tech Colleges	16	361.7	3.7	8.5	4.3%	74.5	27.7
CESA	12	50.6	0.7	1.2	0.6%	10.0	20.5
Total	1,252	8,476.6	111.3	200	100.0%	2,190.4	

Note: Each employer's credit balance (Column E) would be applied to the annual required unfunded liabilities contribution (Column C). This required unfunded liabilities contribution represents a percentage of covered payroll which varies widely among WRS employers. Interest liabilities would continue to accrue during the credit period and add to the outstanding unfunded liabilities (Column F). Credit periods indicated are averages within each WRS employer group; as shown, these too vary by individual employer.

Stip. ¶ 58, P. App. 21.

Thus, for example, while State employers' current contribution rates would not be reduced as a result of the $200 Million reserved for the credit account being included in

the employer reserve and used in the manner prescribed by statute, using the credit account to pay the State employers' obligations for unfunded liability will result in State employers being relieved from such unfunded liability payments for an average of 22.1 months. This represents an aggregate savings to State employers of approximately 56.3 million dollars -- an amount which State employers would otherwise have an absolute obligation to pay into the WRS over the next 22.1 months, and which would otherwise end up in the employer accumulation reserve to fund annuities for WRS participants.

Clearly, the $200 Million employer credit account provides a benefit solely to participating employers, by making employer required payments for unfunded liabilities and/or current service contribution requirements on behalf of participating employers until the credit is exhausted. On average, each participating employer's share of the $200 Million credit account relieves employers from their required payments for between 19.6 and 58.2 months. Stip. ¶ 58, P. App. 20-21.

There is no legitimate trust purpose being served by the employer credit account. The assets of the Trust Fund may only be used to fulfill benefit commitments to WRS participants, as set forth in chapter 40, and "shall not be used for any other purpose." Stip. ¶ 3, P. App. 2-3, § 40.01(2), Stats. Chapter 40 provides (1) that employer

payments for unfunded liability are to be amortized over 40 years; (2)that such payments for unfunded liability must be made until the employer's liability is paid in full; and (3) that employers may pay contributions for unfunded liability in advance. Stip. ¶ 32, P. App. 13-14, §§ 40.05(2)(b),(bg), bm), Stats. Nowhere does chapter 40 authorize the use of assets of the Trust Fund to pay or defer employer required contributions for unfunded liabilities or current service contributions, and the use of Trust Funds in this manner does not satisfy the requirement that Trust Funds be used solely to satisfy benefit commitments to WRS participants. As stated by this Court "the state cannot simply reach into the [Trust Fund] to pay for obligations it has incurred." Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 563, 544 N.W.2d 888, 893 (1996).

In their answer to the Complaint herein, Respondents George Lightbourn, Secretary of the Wisconsin Department of Administration, and Jack C. Voight, State Treasurer (collectively, the "Administration Respondents") took the position that (1)since the $200 Million credit is funded with earnings on employer contributions, participants do not have a property interest and contract right in the $200 Million used to finance the credit account; and (2)that since employer contributions are based on the amount necessary to make up any deficiency in funding the WRS not provided by the combination of projected employee contributions on existing monies in the Trust Fund, and earnings on existing monies in the Trust Fund, that over time the employers will end up having the same

contribution requirements whether it takes the credit up front, as provided in Act 11, or the $200 Million is used in the calculation of future required employer contributions. Administration Respondents Answer, ¶ 43, P. App. 17. Each of these contentions is flawed, and will be addressed in turn.

i. Employer Contributions and the Earnings on Employer Contributions must Be Used Solely for Purposes of Satisfying Benefit Commitments to WRS Participants; There Is No Basis in the Law for the Position That Participating Employers Retain Any Right or Beneficial Interest in Any of the Assets or Earnings of the Trust Fund.

Participants have a vested property interest and contract right in all the assets and earnings of the Trust Fund. Retired Teachers Ass'n v. The Employe Trust Funds Bd., 207 Wis.2d 1, 18, 558 N.W.2d 83, 90 (1997). The vested property interest and contract right held by participants includes an interest in all monies contributed to the Trust Fund by participating employers, and the earnings on all such employer contributions. Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 559-60, 544 N.W.2d 888, 892 (1996), *see, also,* State Teachers' Retirement Board v. Giessel, 12 Wis.2d 5, 10, 106 N.W.2d 301, 305 (1960)(employer and employee contributions, and the earnings thereon, are assets of the retirement system in which beneficiaries have a vested property interest). There is no basis in the law for Respondents' assertion that participants lack a vested property interest in Trust Fund assets derived from the investment of mandatory employer contributions -- such assets were contributed to the Trust Fund for the sole benefit of

participants, belong solely to participants, and are invested in the same manner as all other Trust Fund assets. *Id.,* § 40.04(3), Stats. The mere title of the account or the source of the monies in the account does not affect the vested property interest of participants.

The assets in the employer accumulation reserve can only be used for the purposes specifically authorized by section 40.04, Stats., and these purposes are limited to paying benefits to participants. Nothing in chapter 40 provides that Employers retain any right or beneficial interest in their contributions to the Trust Fund or the assets or earnings contained in any of the Trust Fund's accounts or reserves. *See,* §§ 40.04(5) and 40.05(2) Stats. "Contributions placed in the [employer] accumulation reserve are [to be] applied solely to the payment of fixed monthly annuities [to participants]..." Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 556, 544 N.W.2d 888, 890 (1996). In the absence of specific provisions reserving for participating employers rights and/or beneficial interests in employer contributions to the Trust Fund, no such rights or beneficial interests exist, and none can be imposed by the legislature. *See e.g.* Findorff v. Findorff, 3 Wis. 2d 215, 88 N.W.2d 327 (1958)(Where no right to revoke trust is expressly reserved by trust agreement creating trust, trust is irrevocable), Upham V. Plankinton, 152 Wis. 275, 140 N.W. 5 (1913)(The Legislature cannot legitimately abrogate the right

to have a trust carried out in accordance with the terms of the trust), 76 Am Jur 2d, Trusts § 322 (Trusts are to be administered in accordance with the terms of the trust, and neither a court, nor a beneficiary, nor the legislature has the authority to modify or abrogate the terms of a trust.), *See, also,* State Engineering Association v. Employe Trust Funds Board, 207 Wis.2d 1, 19, 558 N.W.2d 83, 91 (1997)("The legislature [cannot]... spend or appropriate the earnings of the fund [(the Trust Fund])except in a manner authorized by statute relating to the ... retirement system.).[17]

Once employer contributions are deposited in the Trust Fund, they are no different from any other asset of the Trust Fund, and must be used "solely for the purpose of ensuring ... the fulfillment of the benefit commitments to

[17]There is authority that courts may allow deviation from trust terms to deal with emergencies or unanticipated events that threaten the trust and would interfere with the ultimate purpose of the trust. *See, generally,* 76 Am Jur 2d, Trusts § 335. This Court has expressly recognized such a narrow exception with respect to the Trust Fund. Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 558, 563-64, 544 N.W.2d 888, 892 (1996). In the present action, the Parties have stipulated that no such emergencies or threats to the Trust Fund exist. Stip. ¶ 54, P. App. 19.

participants." "Revenues collected for and balances in the accounts of a specific benefit plan shall be used only for the purposes of that benefit plan...." § 40.01(2), Wis. Stats. Nothing in chapter 40 authorizes participating employers to use or borrow trust assets for purposes of paying required employer contributions for current or unfunded prior service liabilities. "The legislature and the plaintiff board are not free to spend or appropriate earnings of the fund except in a manner authorized by statute relating to the [Wisconsin] retirement system." Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 559, 544 N.W.2d 888, 892 (1996). "Unless the appropriation for expenditures of money belonging to the retirement system, whether principal or earnings and regardless of the accounting method which reflects their existence, comes within the purposes of the statutes relating to the ... retirement system, such an appropriation cannot be held valid." State Teachers' Retirement Board v. Giessel, 12 Wis.2d 5, 11, 106 N.W.2d 305 (1960) The employer credit account provisions of Act 11 are not authorized by chapter 40, and deprive participants of their vested property interest and contract right to have the assets and earnings of the Trust Fund used strictly in accordance with the terms of the trust created by Chapter 40.

ii. The Contention That Employers Retain Any Right or Beneficial Interest in Their Contributions to the Trust Fund Is Plainly Inconsistent with the Chapter 40 Requirement That the WRS Be Administered as a Qualified Plan under the Internal

Revenue Code.

The fact that Employers retain no right or beneficial interest in their contributions to the Trust Fund, and cannot use employer contributions for purposes other than paying benefit commitments to WRS participants, is further confirmed by §40.015, Stats. which provides as follows:

> 40.015. Compliance with federal tax laws.
>
> (1) The Wisconsin retirement system is established as a governmental plan and as a qualified plan for federal income tax purposes under the internal revenue code and shall be so maintained and administered.
>
> (2) No benefit plan authorized under this chapter may be administered in a manner which violates an internal revenue code provision that authorizes or regulates that benefit plan or which would cause an otherwise tax exempt benefit to become taxable under the internal revenue code.

Under the Internal Revenue Code, the eligibility requirements for qualified plans are contained in 26 USCA 401(a), which provides in relevant part as follows:

> (a) Requirements for qualification. A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section
>
> ***
>
> (2) **if under the trust instrument it is impossible**, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, **for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries** ... (emphasis added).

Since the WRS is statutorily required to be administered as a qualified plan, it must be impossible under the terms of chapter 40 "for any part of the corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of [participating] employees or their beneficiaries." Act 11 clearly violates this proscription by diverting and using assets of the Trust Fund for the purpose of paying employer required contributions -- a purpose that is not for the benefit of participating employees or their beneficiaries.[18]

iii. Any Future Shortfall Created by Virtue of Using $200 Million Contained in the Employer Accumulation Reserve to Pay Contribution Requirements on Behalf of Participating Employers Will Not Be Made up by Participating Employers Alone, but Rather, Will Be Shared Equally by Participating Employers and Participating Employees.

The Administration Respondents' contend that any shortfall in the Trust Fund that may eventually result from the use of $200 million in the Employer Reserve to fund a

[18]When a plan is qualified, Employers can deposit their contributions in a trust on behalf of employees and take a current deduction for the amount of the contribution, and employees are not taxed on contributions to the trust made by employees or on their behalf, or the earnings thereon, until such contributions and earnings are withdrawn at retirement. Since the governmental entities that participate in the WRS are not subject to federal taxes anyway, the loss of qualification is one born solely by participating employees who will be required to pay, currently, federal income taxes for all contributions and earnings thereon. The risk of losing qualified status under the Internal Revenue Code for the WRS is borne directly by participating employees who are the only ones who have anything to lose if the WRS' qualified status is lost.

contribution credit for participating employers will be made up by participating employers in the form of increased contributions. Therefore, the Administration Respondents assert, any risks to the Trust Fund associated with taking a present $200 Million credit are born solely by participating employers. This contention is inaccurate.

Since 1989, § 40.05(2n), Stats. has provided that when an increase or decrease in contribution rates is necessary to maintain the financial balance of the WRS, any such change is to be apportioned **equally** between the employer-required contribution rate and the benefit adjustment contribution rate paid by participating employees. Stip. ¶ 26, P. App. 11. Thus, any subsequent increase(s) in contribution rates will be split evenly between employers and employees, and 50% of the risk that the $200 Million credit will cause a shortfall at some point in the future rests with participating employees who will share equally in any increase(s) in contribution requirements, and who reap absolutely no benefit from the employer credit account. In effect, the $200 Million is removed from the Employer Reserve, utilized solely by employers, and to the extent this causes or contributes to a necessary increase in contribution rates, participants will have to pay 50% of that increase.

It should be noted that the shared risk associated with the $200 Million credit is not limited to circumstances where there are increases in contribution rates. Any decrease in contribution rates that would be attributable (in whole or in

part) to the $200 Million having remained in the Employer Accumulation Reserve (and earnings thereon) instead of being consumed as a credit pursuant to Act 11, would be a savings shared equally with participating employees. Thus the cost of the credit is being shifted, in part, to participating employees. *See,* R. 13 at 7, P. App. 85 ("Funds used to pay for new benefits [under Act 11] would otherwise have been available to reduce contribution rates...")

iv. It Is Disingenuous to Assert That the Trust Fund Is Equally Secure with an I.O.U. from Participating Employers in Place of Existing Cash Reserves; an I.O.U from Participating Employers Is Not the Equivalent of Cash Reserves

Even to the extent that participating employers bear a portion of the responsibility for making up any shortfall that may result from the $200 Million credit through subsequent increases in Employer Contributions, no weight should be given to any contention that this fact somehow mitigates the taking caused by the employer credit account provisions of Act 11. A $200 Million I.O.U. to be contingently paid back at some undefined point in the future is not the equivalent of $200 Million in cash. The Trust Fund is more secure with cash reserves than it is when such reserves are replaced with a promise of repayment -- this is true without regard to the identity of the creditor. Indeed, this is the fundamental difference between a funded retirement system, such as the WRS, and an unfunded "pay as you go" retirement system. There

is no legal basis for the argument that a state government can convert funds belonging to private citizens for public use and that such a conversion would not constitute a taking so long as the state promises to repay the funds in the future; any such contention should be summarily rejected.

Allowing the "credit" stratagem or device to provide access to Trust Funds would expose all assets of the Employer Reserve to being a source of credit for participating employers and the conversion of the WRS to an unfunded system. There is no principled distinction between the employer credit provisions of Act 11, and a future legislative Act that uses the entire balance of the Employer Reserve to pay current non-trust obligations on behalf of the state or other participating employers. Furthermore, since there is no legal basis for distinguishing between the assets contained in the Employer Reserve, and the assets contained in the other reserves and accounts in the Trust Fund, if the conversion of Trust Fund assets under Act 11 is permissible, then the assets of all of the accounts and reserves in the Trust Fund may be similarly diverted to meet whatever non-trust obligations the state legislature deems appropriate.

v. The Impact of Act 11 on the Actuarial Soundness of the Trust Fund Is Irrelevant in a Takings Analysis; Legislative Intervention into the Trust Fund Is Only Permissible When Necessary to Preserve the Actuarial Soundness of the Trust Fund or to Salvage Financially Troubled Funds.

Throughout the preliminary stages of these proceedings,

Respondents have focused on the question of whether the provisions of Act 11 threaten the actuarial soundness of the Trust Fund. It is respectfully submitted that the answer this question is irrelevant to the outcome of the present action.

In Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 561, 544 N.W.2d 888, 893 (1996), the Respondent argued that since the retirement plan assets affected by the challenged legislation "make up less than one third of one percent of the [] Plan's net assets" that the subject legislation would not diminish or "take" the benefits of plan participants. In rejecting this argument, this Court stated as follows:

> Governmental takings do not become exempt from due process requirements simply because they may be actuarially insignificant. ... The gravity of a property deprivation is irrelevant to the question of whether such rights are violated without due process. ... Any pension plan's ability to meet its obligations can be jeopardized when funds are taken from it, since every dime is arguably part of a management strategy dependent upon spreading the fund's monies as broadly as possible. ... While the specific transfer of trust funds ... may not immediately threaten the benefits of vested ... beneficiaries, the precedent set by such a transfer certainly could.

Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 561-62, 544 N.W.2d 888, 893 (1996)(emphasis added).

The proper question in a takings analysis is whether a recognized private property right has been taken for a public purpose without just compensation and due process of law. If the provisions of Act 11 result in the use of the assets of the Trust Fund for non-trust purposes -- such as using the

Trust Fund as a source of ready cash to meet the State's budgetary cash flow needs (as a source of cash or credit) or as a fund from which employers are free to drain existing cash reserves -- then the legislation is unconstitutional without regard to whether the Trust Fund remains actuarially sound after implementation of Act 11. *Id.* The fact that the Trust Fund may continue to be able to meet its benefit commitments after a taking has occurred is irrelevant. *Id.* This Court has consistently held that Legislation which takes the private property interest of vested beneficiaries without due process of law is invalid without regard to the actuarial significance of the taking. *Id.* At 565, *see, also,* State Teachers' Retirement Board v. Giessel, 12 Wis.2d 5, 10, 106 N.W.2d 301 (1960)(Legislation authorizing expenditure of $18,737.14 to fund a study of retirement systems was not within purpose of retirement system and was invalid; the legislation's impact on the actuarial soundness of the Trust Fund played no part in this Court's decision); Retired Teachers Ass'n v. The Employe Trust Funds Bd., 207 Wis. 2d 1, 558 N.W.2d 83 (1997) (Legislation which used approximately $82 million in WRS assets to pay general purpose revenue obligations of the state for supplemental benefits takes the property of WRS participants without just compensation and is invalid; the legislation's impact on the actuarial soundness of the Trust Fund played no part in this Court's decision).

Asking whether the Trust Fund remains actuarially sound

after the implementation of Act 11 misstates the issue. This Court has adopted the rule -- much like that adopted in other states -- that prohibits legislative intervention into the Trust Fund except in circumstances where such intervention is "necessary to preserve the actuarial soundness of [the] plan or to salvage financially troubled funds." *Id.* at 563, *see also,* Spina v. Consolidated Police and Firemen's Fund, 41 N.J. 391, 197 A.2d 169, 176 (1969)(allowing legislative intervention into the employee retirement fund when the plan was unable to meet its present and future benefit commitments), 60A Am Jur 2d, Pension and Retirement Funds § 1623. As stated by this Court in invalidating the legislation at issue in Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 558, 544 N.W.2d 888, 892 (1996):

> In the present case, the County Plan was neither insolvent nor in fiscal distress. The purpose of Wis. Stat. § 978.12(5)(c)5 was not to improve the actuarial soundness of the pension plan... This case does not present one of those situations in which legislative intervention may be needed.

All legislation which modifies the WRS and deprives participants of their vested property rights is invalid *unless* such intervention is needed and necessary to preserve the actuarial soundness of the Trust Fund. The parties have stipulated that the Trust Fund is not financially troubled, and the provisions of Act 11 are not needed or necessary to protect the actuarial soundness of the Trust Fund or to salvage the Trust Fund. Stip. ¶ 54, P. App. 19. It is

respectfully submitted that the legislation at issue does not come within the narrow exception permitting legislative intervention into the Trust Fund.

vi. The Taking at Issue Poses a Systemic Threat to the Solvency and Actuarial Soundness of the Trust Fund

The SEA Petitioners do not contend that the provisions of Act 11, in and of themselves, leave the Trust Fund in a financially troubled condition. Act 11, however, does pose a systemic threat to the Trust Fund. If Trust Fund assets may be used to meet non-trust obligations, then the substantial assets of the Trust Fund are at risk for future legislative conversions that could threaten the solvency and actuarial soundness of the Trust Fund. The very ability to remove dollars from the Trust Fund, either directly or indirectly, for purposes other than paying benefit commitments associated with those funds, poses a significant danger to the future security of the Trust Fund.

In invalidating legislative enactments that utilize assets of a pension system in a manner not authorized by the plan, this Court has specifically recognized the systemic threat that such legislation poses to a pension system. "While the specific transfer of trust funds ... may not immediately threaten the benefits of vested ... beneficiaries, the precedent set by such a transfer certainly could." Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 558, 544 N.W.2d 888, 892 (1996)(emphasis added). If

such legislative grabs at the assets of a public pension system are permissible, "the actuarial soundness of the plan could eventually suffer." *Id.* at 562. The systemic threats that Act 11 poses to the pension system are duly noted in the Joint Survey Committee Report on Assembly Bill 495, which is attached as an Appendix to Assembly Bill 495:

> [U]sing accumulated capital gains from the Transaction Amortization Account to finance part of this benefit increase legislation [] would seriously reduce the TAA and weaken its effectiveness for the retirement system as a buffer against economic adversity. And history has repeatedly taught us that bad times do follow good.

P. App. 93.

This Court should continue to be unwavering in its holdings concerning the use of WRS assets and modifications to the WRS contract. WRS assets may only be used in strict accordance with the terms of chapter 40, and legislative intervention into the fund is only constitutional when such intervention is necessary to preserve the actuarial soundness of the Trust Fund. By adhering to these clear bright line rules, the integrity of the Trust Fund can be preserved and the vested property rights of participants can be protected.

B. The Provisions of Act 11 Which Change the Actuarial Assumptions Used in Determining Contribution Rates Are Invalid Because They Violate the WRS Contract, and Unlawfully Take Participants' Property Interest in Having Such Actuarial Assumptions Determined by the Actuary and Approved by the ETF Board.

As described in greater detail, *supra,* Act 11 makes changes to the actuarial assumptions used in determining employer and employee contribution rates to the Trust Fund. These changes include (1) Changing the "assumed rate" under §

40.02(7) from 7.5% to 8% (Stip. ¶ 29, Act 11, § 5); and (2)changing the actuarial assumption for across-the-board salary increases under § 40.02(7) from 1.9% less than the assumed rate to 3.4% less than the assumed rate. Under § 40.02(7), Stats., these assumptions can only be changed when "due to changed economic circumstances, the actuary recommends and the board approves" such changes to the assumptions.

The changes to the actuarial assumptions made by Act 11 violate the WRS contract and are invalid. Under the WRS contract, the ETF Board is vested with the exclusive authority to make changes to the actuarial assumptions, and this authority can only be exercised when such changes are "recommended by the actuary" "due to changed economic circumstances". The provisions of Act 11 which change the assumed rate and the actuarial assumption for across-the-board salary increases were not recommended by the actuary, were not based on changed economic circumstances, and were not approved by the ETF Board. Rather, the changes were mandated by the legislature in direct violation of § 40.02(7), Stats.

This Court has held that when "an exclusive grant of discretionary authority [has been given] to the ETF Board ... [legislation that] eliminates or limits the ETF Board's discretion" violates the WRS contract. Retired Teachers Ass'n v. The Employe Trust Funds Bd., 207 Wis. 2d 1, 20, 558 N.W.2d 83, 91 (1997). Violations of the WRS contract deprive participants of their vested property interest in the WRS and

are invalid. *Id.* at 24. This "taking" is for a public purpose because the changes to the actuarial assumptions have the effect of reducing employer required contributions to the Trust Fund, and are thereby are being used to finance the benefit improvements to WRS participants provided by Act 11. R. 13 at 5, P. App. 84A. Providing benefit improvements for participants in the WRS inures to the benefit of the public, and constitutes a "public purpose." Retired Teachers Ass'n v. The Employe Trust Funds Bd., 207 Wis. 2d 1, 24, 558 N.W.2d 83, 93 (1997).

The Joint Survey Committee Report on Assembly Bill 495[19] expressly warned of the systemic threat that would result from allowing the legislature to intervene in setting actuarial assumptions as provided in Act 11:

> [I]ncreasing the economic spread by legislative *fiat* weakens the system of trusteeship that has been set up as a safeguard for the Wisconsin Retirement System. It is the responsibility of the system's trustees, the Board of the Department of Employe Trust Funds, acting in consultation with the retirement system's actuaries, to determine what actuarial valuation assumptions are prudent and in the system's best interest. For the legislature to assume that duty can well be argued to be presumptuous and setting a dangerous precedent for the management of the retirement system. Most legislators are not retirement plan experts. Many of the DETF trustees are.

P. App. 93.

Fundamental to the WRS contract are those provisions designed to protect the security of the WRS. The structure of

[19]This report was an appendix to AB 495.

the WRS depends for its security on the exercise of independent judgment by plan fiduciaries, and the system's reliance on sound actuarial principles and advice. Legislative intervention into those areas reserved exclusively to plan fiduciaries and their selected actuaries violates the WRS contract, and threatens the integrity and security of the Trust Fund.

VI. ACT 11 VIOLATES THE MANDATES OF ARTICLE IV. §26 OF THE WISCONSIN CONSTITUTION BECAUSE IT WAS NOT PASSED BY A THREE-FOURTHS VOTE OF BOTH HOUSES OF THE LEGISLATURE, AND BECAUSE IT FAILS TO PROVIDE SUFFICIENT STATE FUNDS TO COVER THE COST OF THE INCREASED BENEFITS MANDATED BY THE ACT.

Article IV., §26 of the Wisconsin Constitution provides in relevant part as follows:

> (1) The legislature may not grant any extra compensation to a public officer, agent, servant or contractor after the services have been rendered or the contract has been entered into.
>
> ***
>
> (3) Subsection (1) shall not apply to increased benefits for persons who have been or shall be granted benefits of any kind under a retirement system when such increased benefits are provided by a legislative act passed on a call of ayes and noes by a three-fourths vote of all the members elected to both houses of the legislature and such act provides for sufficient state funds to cover the costs of the increased benefits.

Act 11 provides increased benefits to participants, including the following:

* Act 11 increases the percentage multipliers used in calculating a participant's annuity for creditable

> service that is performed before January 1, 2000. For a protective occupation participant who is covered by Social Security, an elected official and an executive participating employee, the percentage multiplier is increased from 2% to 2.165%. For a protective occupation participant who is not covered by Social Security, the percentage multiplier is increased from 2.5% to 2.665%. For all other participants in the WRS, the percentage multiplier is increased from 1.6% to 1.765%.

Act 11, §§ 17-20, P. App. 76.

> * Act 11 increases the cap on the initial formula-based annuity for WRS participants who are not protective occupation participants with social security from 65% to 70% of the participant's final average earnings.

Act 11, § 16, P. App. 75.

The benefit improvement provisions of Act 11 are invalid for their failure to comply with the requirements of Article IV, Section 26 of the Wisconsin Constitution. First, Act 11 was not passed by "a three-fourths vote of all the members elected to both houses of the legislature." Stip. ¶52, P. App. 19. The vote in the Senate was 23 ayes and 10 noes. *Id.*

Second, the benefit improvements of Act 11 are invalid for the State's failure to "provide[] for sufficient state funds to cover the costs of the increased benefits." The Appendix to 1999 Assembly Bill 495 contains the Report of the Joint Survey on Retirement Systems. Within this report is an explanatory note concerning the $4 Billion recognition from the TAA:

> [T]his $4 billion amount was estimated to be the sum of (i)an amount (approximately $650 million) sufficient to fund Item 6. (below) [(Item 6. is the employer credit account provision of Act 11)] <u>plus</u> (ii) an amount such that the average employer's share would <u>for the year 2001</u>

only defray any additional contribution generated by this bill.

***

The $4 billion TAA transfer under this bill was solved for as the amount that would defray any additional contributions from this bill for the average WRS employer (not necessarily for all employers) during the year 2001 only. The best estimate now available is that $3,632 Million would accomplish this. The $200 Million 'Unfunded Liability credit' feature of this bill, when coupled with the employers' share of the $4 Billion transfer in excess of this $200 million, actually causes a net reduction in WRS contribution for employers for both years 2001 and 2002 that is estimated at $28.1 million. This is true in the aggregate, not for every employer.

P. App. 87, 90, *see, also,* Stip. ¶ 56, P. App. 19-20.

Thus the benefit improvements contained in Act 11 are, through at least the 2001 calendar year, funded with assets of the Trust Fund. Assets contained in the Trust Fund are not "State Funds". Opinion of Wis. Att'y Gen. To Michael G. Ellis, Chairperson, Senate Organization Committee, OAG 1-95, 1995 WL 64369 (Feb. 14, 1995), State Engineering Association v. Employe Trust Funds Board, Dane County Case Nos. 88-CV-1070 and 88-CV-4062, Decision and Order at 8-9, *affirmed in part and reversed in part*, 537 N.W.2d 400 (Ct. App. 1995), *affirmed as modified*, 207 Wis.2d 1, 558 N.W.2d 83 (1997), P. App. 103-104 (public employe trust funds are not "state funds" because those funds have been irrevocably placed in trust for the benefit of state employes, and the state itself has given up any right to direct their use). The State's failure to provide sufficient state funds to pay for the cost of the benefit improvements contained in Act 11 violate Article IV, Section

26 of the Wisconsin Constitution.

CONCLUSION

The appropriate use of assets of the Trust Fund is well defined by existing law, and is governed by contract terms and vested constitutional rights. Proper use of Trust Funds should not be a matter of politics and horse-trading. The Legislature is without authority to authorize the use of Trust Fund assets for the benefit of participating employers or as a source of funding additional benefits for past service whether this is done by directly withdrawing cash; using a credit as a stratagem for benefitting from Trust Fund assets; or mandating changes to actuarial assumptions in a manner that provides a fiscal benefit to participating employers. In any event, it is clear that Act 11 results in the use of Trust Fund assets to pay for, reduce, or defer the statutory obligations of participating employers, thus freeing up dollars for other public purposes.

There are numerous interest groups and public needs that can befit from a diversion of Trust Funds. Act 11 is a good example of yet another attempt to tap the resources of the WRS Trust Funds to pay for public obligations in benefit of participating employers. This is largely achieved by reaching a political accommodation with those that see some benefit from the enhanced benefit levels for past services. It should be manifest that if the assets of the Trust Fund are turned into a means of political exchange, the future security of the Trust Fund is in grave danger. Assets of the Trust Fund can

only be used in accordance with the terms of chapter 40. This limitation, although inconvenient and frustrating to some political interests, is ultimately the most vital assurance to the integrity and long term viability of the WRS.

The financial success of the WRS in recent years, coupled with the inherent complexity of the pension system, makes the WRS a prime target for creative legislation that diverts Trust Fund assets to meet the increasing fiscal demands on State and local governments. The important issue in evaluating these cases, however, is what is being done, rather than how it is being done. If participating employers manage to gain economic benefit from Trust Fund assets (other than through the economic activity generated by the payment of benefits), it is more than likely that something is wrong. If increased benefits for past services (other than by distribution of dividends) are implemented without any cost to the participating employers, it is more than likely that something is wrong. If participating employers look to the Trust Funds to determine "what's in it for me?" it is more than likely that something is wrong. There is a sacred trust that underlies the WRS and many people have worked hard and earned the benefit of that sacred trust. It cannot be allowed to be undermined for short term political interests and public financial needs in derogation of the contractual and constitutional rights of those that provided many years of public service in reliance on the sacred trust. The law

requires and there should be a "firewall" between the Trust Funds and those that are tempted by its seeming availability. These are trust funds; not political capital.

Property rights protected by the federal and state Constitutions are substantive in nature and cannot be defeated or subverted by an artifice, no matter how good it looks or how clever it seems. There is no difference between allowing participating employers to remove $200 million from the Trust Fund to build schools and highways and using $200 million in Trust fund assets as a credit in satisfaction of participating employers' contribution requirements to the Trust Fund. Each permits and results in the use of Trust Fund assets for non-trust purposes, and each results in participating employers having (in the aggregate) 200 million additional dollars in their budgets that can be used for whatever public purpose they choose. The bottom line is that the WRS Trust Fund is an irrevocable trust and it must be so in order for the WRS to constitute a qualified plan under the Internal Revenue Code. It is unlawful for the Legislature and the fiduciaries of the WRS to use any means whatsoever to divert trust funds from the their very limited and proper purpose.

The provisions of Act 11 challenged herein are invalid for their violation of the WRS Contract, and because they take the vested property rights of WRS participants without due process and without just compensation in violation of the Wisconsin and United States Constitutions. It is therefore

respectfully requested that this Court sever the invalid and unconstitutional provisions of Act 11 from those that are valid, and permanently enjoin the implementation of the invalid and unconstitutional provisions as follows:

1. Declare that Act 11, § 27(1)(b) is invalid and unconstitutional, and that it violates Petitioners' contractual and property rights.
2. Declare that Act 11, § 5 is unconstitutional to the extent it changes and manipulates the assumed rate and the actuarial assumption for across the board salary increases set forth in section 40.02(7), Stats. in a manner that is not consistent with the terms of Chapter 40.
3. Declare that Act 11 §§ 17-20 providing for and funding an increase in the formula multiplier for creditable service prior to January 1, 2000, but failing to provide state funding for such increased benefits, violates Wis. Const. Art. IV, § 26.

Dated this 6th day of July, 2000.

HAUS, RESNICK and ROMAN, LLP
Attorneys for the SEA Petitioners

Michael E. Banks
State Bar No.1022148
William Haus
State Bar No.1015390

MAILING ADDRESS:

148 East Wilson Street
Madison, WI 53703
Telephone: (608) 257-0420
Facsimile: (608) 257-138